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## BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE  
APPLICATION OF ARIZONA-  
AMERICAN WATER COMPANY  
FOR A LIMITED WAIVER OF THE  
REQUIREMENTS OF A.A.C. R14-2-  
801, ET SEQ., AND CERTAIN  
RELATED RELIEF.

DOCKET NO. W-01303A-01-0983

ARIZONA-AMERICAN WATER  
COMPANY'S APPLICATION FOR  
REHEARING OF DECISION NO. 65453

Pursuant to A.R.S. § 40-253, Arizona-American Water Company (hereinafter "Arizona-American" or "the Company") submits this Application for Rehearing (the "Application") of Decision No. 65453, filed December 12, 2002 (the "Decision"). In addition to and in support of the issues raised in this Application, Arizona-American incorporates by reference the matters set forth in (1) its Closing Brief filed in this docket on September 6, 2002, and (2) its Exceptions to Recommended Opinion and Order filed in this docket on November 13, 2002.

For the reasons set forth below, the Decision is unreasonable, unlawful, arbitrary, capricious, not supported by substantial evidence and in excess of the Commission's jurisdiction. The Company requests that the Commission grant rehearing and issue a modified decision either (1) approving the transaction pursuant to A.A.C. R14-2-803 with none of the conditions set forth in Finding of Fact No. 21, as amended; (2) approving the transaction pursuant to said finding but removing Condition 15, which prohibits the

1 Company from seeking rate increases for a period of three years; or, in the alternative, (3)  
2 granting a the Company waiver, or concluding that the Commission has no jurisdiction over  
3 the transaction, pursuant to A.A.C. R14-2-806.

4 **A. Overview Of The Transaction And Decision.**

5 As explained in the Company's Closing Brief at pages 3 to 8 and incorporated  
6 herein by reference, and reiterated in Decision No. 65453 at pages 2 to 4, Arizona-  
7 American is an Arizona corporation that currently provides water and wastewater services  
8 in Maricopa, Mohave and Santa Cruz Counties. Arizona-American is a wholly-owned  
9 subsidiary of American Water Works Company, Inc., a Delaware corporation ("AWW").  
10 AWW is a publicly-traded company, headquartered in Voorhees, New Jersey. It has more  
11 than 60 subsidiaries (both regulated and unregulated), which collectively have a business  
12 presence in 27 states and three Canadian provinces, including regulated water utilities in  
13 over 20 states.

14 The subject transaction concerns an agreement made by and between AWW, RWE  
15 AG, a company organized under the laws of the Federal Republic of Germany ("RWE"),  
16 and Thames Water Aqua Holdings GmbH, a company organized under the laws of the  
17 Federal Republic of Germany and a wholly-owned subsidiary of RWE ("Thames  
18 Holdings"). Under this agreement, all of AWW's issued and outstanding common stock  
19 will be acquired by Thames Water Aqua U.S. Holdings, a Delaware corporation and a  
20 wholly-owned subsidiary of Thames Holdings. Arizona-American is not a party to the  
21 agreement, and its common stock ownership will not change.

22 Both RWE and Thames Holdings are large industrial concerns, with business  
23 operations throughout the world, including extensive water and wastewater utility  
24 operations. Following completion of the transaction, AWW will remain in existence as a  
25 wholly-owned subsidiary of Thames Water Aqua U.S. Holdings and be responsible for  
26 managing the Americas region of Thames' utility operations. Arizona-American will

1 continue to be a wholly-owned subsidiary of AWW and will continue to provide water and  
2 wastewater utility services in Arizona under the Commission's jurisdiction. Local and  
3 regional management will not change and there will be no reduction in Arizona-  
4 American's local staffing as a result of the transaction.

5 In addition, there will be no changes in Arizona-American's rates and charges for  
6 service as a result of the transaction. Arizona-American's capital structure will not  
7 change. There will be no request to recover any acquisition premium or any other costs  
8 associated with the transaction. There will not be any cross-subsidization of any affiliates  
9 and any transactions between Arizona-American and any "affiliate," as such term is  
10 defined in A.A.C. R14-2-801, will continue to be subject to the Affiliated Interests Rules  
11 and other regulatory requirements of the Commission. Put simply, the transaction will be  
12 "transparent" to Arizona-American and its utility customers. There is no evidence in the  
13 record of any adverse impact on Arizona-American's customers as a result of the  
14 transaction.

15 In the Decision, the Commission granted approval of the transaction pursuant to  
16 A.A.C. R14-2-803, subject, however, to 15 conditions imposed on Arizona-American,  
17 including the requirement that the Company "refrain from filing any non-emergency rate  
18 increase requests for three years from the closing of the reorganization." Decision,  
19 Finding of Fact No. 23 at page 17. The Commission denied the Company's request for a  
20 waiver from Commission review of the transaction without any explanation. The  
21 Commission also denied the Company's alternative request that the Commission  
22 determine it has no jurisdiction over the transaction, stating, in conclusory fashion and  
23 without explanation, that it has jurisdiction pursuant to Article 15, Section 3 of the  
24 Arizona Constitution and the Commission's Affiliated Interests Rules, A.A.C. R14-2-801,  
25 *et seq.* The waiver denial, the assertion of jurisdiction over the transaction and the  
26 imposition of conditions in these circumstances are each incorrect as a matter of fact and

1 law. Arizona-American seeks rehearing and modification of the Decision on each of those  
2 grounds.

3 **B. The Commission Lacks Jurisdiction to Impose Any Conditions in Connection**  
4 **With Approval of the Transaction.**

5 A.A.C. R14-2-803 requires any utility or affiliate intending to reorganize an  
6 existing public utility holding company to notify Staff in writing at least 120 days prior to  
7 the reorganization, and to provide certain specified information. Although the  
8 Commission may reject the proposed reorganization, it may do so only on one or more of  
9 three specific grounds:

- 10 (1) The transaction would impair the financial status of the public utility;  
11 (2) The transaction would prevent the public utility from attracting capital at fair  
12 and reasonable terms; or  
13 (3) The transaction would impair the ability of the public utility to provide safe,  
reasonable and adequate service.

14 As explained in the Company's Closing Brief at pages 9 to 13, and again in its  
15 Exceptions at pages 5 to 6, which are incorporated herein, the evidence plainly shows that  
16 each of the three criteria is satisfied and, consequently, no conditions are justified. First,  
17 there is no evidence that the transaction "would impair the financial status" of Arizona-  
18 American. The evidence shows that Arizona-American's capital structure will not change  
19 as a result of the transaction, nor will any expenses associated with the transaction be  
20 passed on to Arizona-American. Arizona-American will continue to exist as a wholly-  
21 owned subsidiary of AWW and effectively operate as a stand-alone entity subject to this  
22 Commission's jurisdiction.

23 The second criterion is also satisfied. There is no evidence that the transaction  
24 would prevent Arizona-American "from attracting capital at fair and reasonable terms."  
25 In fact, Staff acknowledged that to the extent the transaction affects Arizona-American's  
26 ability to attract capital at all, that impact will be *positive* based on RWE's superior credit

1 ratings, RWE's access to international capital markets and RWE's larger market  
2 capitalization.

3 Finally, there was no dispute that the third criterion in the rule is satisfied. The  
4 Staff engineering witness investigated the impact of the transaction on Arizona-  
5 American's ability to "provide safe, reasonable and adequate service," and concluded that  
6 he foresees no adverse impact as a result of the transaction.

7 In short, there is no evidence that would allow the proposed reorganization to be  
8 rejected under the criteria established by the Commission in R14-2-803(C). Therefore, the  
9 Commission's assertion that the "public interest" – a subjective term that is not one of the  
10 criteria set forth in the regulation – "requires" that the transaction be approved subject to  
11 each of the 15 conditions is unsupported by the record and contrary to the Commission's  
12 own rule. Very simply, there is no basis in fact or law for *any* of the conditions imposed  
13 by the Decision.

14 **C. Condition 15 is Unlawful, Unreasonable and Confiscatory.**

15 Condition 15 prohibits Arizona-American from applying for any rate increases for a  
16 period of three years from the date on which the transaction closes. To the undersigned's  
17 knowledge, the imposition of a moratorium of this nature and duration, outside a  
18 settlement with a utility, is unprecedented. Even assuming the Commission had  
19 jurisdiction to impose conditions on its approval of the transaction, which it does not,  
20 Condition 15 violates the Company's due process rights under the Fifth and Fourteenth  
21 Amendments to the United States Constitution and, in addition, Arizona-American's right  
22 to earn a reasonable return on the fair value of its property devoted to public service under  
23 Article 15 of the Arizona Constitution.

24 The need for such a condition is wholly without support in the record. In fact, the  
25 requirement of a three-year moratorium was first raised by the Commissioners themselves  
26 during the December 9, 2002 Open Meeting, where this condition was ultimately imposed

1 to provide "greater protection to Arizona ratepayers." Decision No. 65453, Finding of  
2 Fact No. 23 at page 17. As a consequence, the Company was deprived of any meaningful  
3 opportunity to present evidence and argument as to the effects of precluding Arizona-  
4 American from seeking a rate increase for three years following the close of the AWW  
5 and RWE transaction.

6 Article 15, Sections 3 and 14 of the Arizona Constitution assures Arizona-  
7 American, and every public service corporation, of the right to impose and collect rates for  
8 the provision of utility services that produce a fair return on the fair value of its property.  
9 As the Arizona Court of Appeals stated in *Scates v. Arizona Corporation Commission*,  
10 118 Ariz. 531, 533-534, 578 P.2d 612, 614-615 (App. 1978), "rates cannot be considered  
11 just and reasonable if they fail to produce a reasonable rate of return." Similarly, the  
12 United States Supreme Court has stated:

13 Rates which are not sufficient to yield a reasonable rate of  
14 return on the value of the property used to render the service  
15 are unjust, unreasonable and confiscatory, and their  
16 enforcement deprives the public utility company of its  
property in violation of the Fourteenth Amendment. This is  
so well settled by numerous decisions of this court that a  
citation of cases is scarcely necessary.

17 *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of West Va.*, 262 U.S.  
18 679, 690 (1923) (citing numerous Supreme Court decisions).

19 In this case, the Commission has effectively prejudged Arizona-American's rate of  
20 return on a prospective basis for a period of at least three years, and in so doing has  
21 prohibited the Company from seeking rate increases, as necessary to provide a just and  
22 reasonable rate of return. This clearly violates Arizona's constitutional mandates as well  
23 as fundamental due process requirements protected under the United States Constitution  
24 by forcing Arizona-American to devote its property to a public use without the opportunity  
25 to recover a reasonable return on its utility plant and property.

26

1     **D.     The Commission also Erroneously Concluded that it has Jurisdiction over the**  
2     **Transaction and Should Not Waive the Requirements of the Rules.**

3             The Commission's Affiliated Interests Rules, A.A.C. R14-2-803, *et seq.*, and, more  
4     generally, its jurisdiction over public service corporations under Article 15, Section 3 of  
5     the Arizona Constitution – the jurisdictional bases set forth in the Decision - simply do not  
6     extend to this transaction. As discussed in greater detail at pages 20-23 of the Company's  
7     Closing Brief, which is incorporated herein, the Affiliated Interests Rules apply *only* to  
8     public service corporations in the business of furnishing utility service in Arizona. *Ariz.*  
9     *Corp. Comm'n v. State ex rel. Woods*, 171 Ariz. 286, 298, 830 P.2d 807, 819 (1192) (the  
10    Affiliated Interests Rules "apply on to public utilities subject to the Commission's  
11    jurisdiction," and "only regulate transactions between those utilities and their affiliates").

12            In this case, none of the parties to the transaction (AWW, RWE and Thames  
13    Holdings) are Arizona corporations, and, moreover, none of them are public service  
14    corporations providing utility service in Arizona. The Arizona utility, Arizona-American,  
15    is neither forming a holding company nor engaging in a transaction with an affiliate. This  
16    is not the sort of transaction that the Affiliated Interests Rules were intended to regulate.  
17    *See, e.g.*, Decision No. 56844 (March 14, 1990), Finding of Fact No. 2 at 3 ("The purpose  
18    of the [Affiliated Interests] rules is to regulate the formation of public utility holding  
19    companies and certain transactions *between a public service corporation and affiliated*  
20    *interests*"; italics supplied).

21            In addition to exceeding the scope of its jurisdiction under Arizona law, by  
22    asserting jurisdiction over the transaction the Commission is regulating a business  
23    transaction between foreign (*i.e.*, non-Arizona) corporations and their shareholders in  
24    contravention of the Commerce Clause of the United States Constitution. U.S. Const. Art.  
25    I, § 8, cl. 3. *See, e.g.*, *Woods*, 171 Ariz. at 297, 830 P.2d at 818. The Commission itself  
26    has previously determined that "a foreign corporation engaged in interstate commerce

1 need not secure the consent or approval of the Arizona Corporation Commission to issue  
2 stocks and stock certificates, bonds, notes and other evidences of indebtedness," even  
3 though the Arizona legislature has delegated the Commission authority to review and  
4 approve such transactions. *PHASER Advanced Metering Services*, Decision No. 61895  
5 (Aug. 27, 1999).

6 Under Arizona law, the Commission does not have jurisdiction over the sale or  
7 other transfer of stock that is issued and outstanding. *Ariz. Corp. Comm'n v. Consolidated*  
8 *Stage Co.*, 63 Ariz. 257, 263, 161 P.2d 110, 112 (1945) ("Chaos would result . . . if the  
9 Corporation Commission, under the mantle of state authority, were permitted to dictate to  
10 a corporation to whom to issue and transfer its shares of stock."). By attempting to  
11 regulate this transaction and, in the process, imposing conditions on Arizona-American  
12 under the guise of protecting the "public interest," *i.e.*, Arizona ratepayers, the  
13 Commission has impermissibly interfered with AWW's shareholders' right to sell their  
14 stock as well as AWW's internal management of its business. "It must never be forgotten  
15 that, while the state may regulate with a view to enforcing reasonable rates, it is not the  
16 owner of the property of public utility companies, and is not clothed with the general  
17 power of management incident to ownership." *State of Missouri ex rel. Southwestern Bell*  
18 *Telephone Co. v. Pub. Serv. Comm'n of Missouri*, 262 U.S. 276, 289 (1923). There is  
19 simply no legal basis for the Commission to extend its jurisdiction to this transaction  
20 under the agency's authority to set local utility rates.

21 Finally, even assuming the Commission does have jurisdiction, Arizona-American  
22 has satisfied the requirements for a waiver from the Affiliated Interests Rules pursuant to  
23 R14-2-806. The Company presented uncontested evidence indicating that Arizona-  
24 American is likely to benefit in several financial and other respects as a result of the  
25 transaction.

26



1 **E. Conclusion**

2 The Company requests that the Commission grant rehearing and thereafter issue a  
3 modified decision (1) approving the transaction without any conditions; (2) approving the  
4 transaction, but with Condition 15 eliminated; or, in the alternative, (3) concluding that the  
5 Commission has no jurisdiction over the transaction and/or, in these circumstances, the  
6 requirements of A.A.C. R-14-2-806 should be waived.

7 RESPECTFULLY SUBMITTED this 30<sup>th</sup> day of December, 2002.

8 FENNEMORE CRAIG, P.C.

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13 ORIGINAL and 13 copies of the  
14 foregoing was hand-delivered for filing this  
30<sup>th</sup> day of December, 2002, to:

15 Docket Control  
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17 COPY of the foregoing was hand-  
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